No. 21,165

IN THE

United States Court of Appeals
For the Ninth Circuit

American Telephone and Telegraph Company, Security Savings and Loan Association and Victoria Savings and Loan Association, *Appellants,*

vs.

Federal Deposit Insurance Corporation, etc., et al., *Appellees.*

BRIEF OF APPELLEES FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver of San Francisco National Bank, and FEDERAL DEPOSIT INSURANCE CORPORATION, as Insurer of Deposits in San Francisco National Bank

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PRELIMINARY STATEMENT

American Telephone and Telegraph Company (Telephone Company) sued a large number of parties. The defendants may be divided into two classes. The first class consists of three named parties, i.e., San Francisco National Bank (the Bank), Federal Deposit Insurance Corporation (FDIC) as receiver of

the Bank, and FDIC as insurer of the Bank's deposits. The other group consists of 88 depositors in the Bank.

The Pleadings

The complaint consists of five counts. The first count[1] alleges in substance that on January 22, 1965, the Comptroller of the Currency declared the Bank insolvent and appointed FDIC as its receiver; that plaintiff held a $500,000 certificate of deposit of the Bank, which was renewed on December 28, 1964; that the Bank was then insolvent or in imminent danger of insolvency; that the defendant depositors had received illegal interest in the form of bounties; that the Bank had concealed those facts and other illegal acts from plaintiff, which would not otherwise have renewed its certificate; that plaintiff had rescinded the renewal, and demands the $500,000. The second[2] and third[3] counts allege that the facts gave rise to a constructive trust, the second count being in favor of plaintiff, and the third being in favor of plaintiff and depositors who had not accepted bounties. The fourth count[4] alleges that plaintiff is entitled to a preference against bounty depositors and against FDIC as subrogee of such depositors to the extent of insurance paid by it to them on their deposits. The fifth count[5]

[1] Tr., 4-7.
[2] Tr., 7-8.
[3] Tr., 8-9.
[4] Tr., 9-10.
[5] Tr., 10-11.

seeks an injunction against any distribution by the receiver prior to adjudication of claims of the parties.

In its answer,[6] FDIC in substance denies that plaintiff is entitled to special rights and alleges that all the creditors are entitled only to ratable distribution.

Two of the depositors who filed answers included counterclaims and cross-claims. They are Victoria Savings and Loan Association (Victoria)[7] and Security Savings and Loan Association (Security).[8]

Victoria denied receiving a bounty, or that it should be subordinated to plaintiff;[9] and alleged that it too should be the beneficiary of any constructive trust.[10] As counterclaim and cross-claims[11] against plaintiff and the other defendants, it alleges that on January 20, 1965, it received from Bank a cashier's check for $360,000 and a certificate of deposit for $150,000 in place of deposits totalling $500,000 and accrued interest of $10,000; that the Bank was then insolvent and known to be so by its officers and FDIC but the fact was concealed from Victoria, which would otherwise have demanded cash; that Victoria has rescinded and demanded the $500,000 from the receiver; that the other defendants received bounties, and that Victoria is entitled to a constructive trust and prefer-

[6]Tr., 77-89.
[7]Tr., 15-34.
[8]Tr., 191-208.
[9]Tr., 16, 18-19.
[10]Tr., 18.
[11]Tr., 20-34.

ence, and asks for injunction pending adjudication of rights. It adds a count[12] alleging wrongful acts by the Bank officials, the FDIC, the Comptroller of the Currency and the Federal Reserve Bank in the operation of the Bank, which it asserts should cause subordination of FDIC's claims as subrogee to the claims of innocent depositors.

Security by its answer alleges that it holds renewed certificates of deposit totalling $600,000, and that it received only the legal rate of interest.[13] It makes substantially the same allegations as Telephone Company regarding insolvency and regarding receipt of bounty by other depositors.[14] It denied that plaintiff is entitled to a constructive trust or preference, and claims that it is entitled to such against plaintiff and the other defendants; or that if plaintiff is entitled to superior rights, Security is similarly entitled.[15]

In its answer to the cross-claims of Victoria[16] and Security,[17] FDIC in effect reiterates the position taken by it in its answer to the complaint of Telephone Company. It denied the allegations of wrongdoing contained in Victoria's cross-claim. In addition, FDIC asserts some affirmative defenses including the defense that the claims of cross-claimants are barred by the Federal Tort Claims Act.

[12]Tr., 29-34.
[13]Tr., 191-192.
[14]Tr., 192-193.
[15]Tr., 194-202.
[16]Tr., 432-444.
[17]Tr., 62-74.

The Orders Appealed From

The appeals are from three orders, one of April 13,[18] and the other two of May 25, 1966.[19] One of the May 25 orders was merely a denial of a motion to vacate the one of April 13. We therefore limit our discussion to the other two.

The order of April 13 was made by Judge Mathes of his own motion. It dismissed the action and the cross-actions for lack of jurisdiction over the subject matter as to all defendants except FDIC, and as to FDIC it dismissed the same "in the exercise of the Court's discretion . . . insofar as declaratory relief is sought."

Then on May 25, in response to a motion of FDIC, it dismissed the action as to all parties, so that there was nothing left.

Three Appeals, and the Plan of this Brief

Three parties have appealed: plaintiff Telephone Company,[20] and defendants and cross-claimants Victoria[21] and Security.[22] Telephone Company and Victoria have each filed briefs, and Security has adopted Telephone Company's brief. Because of the similarity of the issues, and by stipulation and leave of court, appellee FDIC files this brief in response to the briefs filed on behalf of the three appellants.

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[18]Tr., 90-94.

[19]Tr., 155-156; Tr., 157-158.

[20]Tr., 457-458.

[21]Tr., 159-160.

[22]Tr., 469-470.

We will first respond to Telephone Company. We will then discuss any points relating specifically to Victoria or Security.

This brief of appellees is filed by FDIC in its two capacities. These two capacities rise from the statute of Congress which creates FDIC, 12 U.S.C. §§ 1811 et seq. As receiver, FDIC marshalls the assets and pays the liabilities of the bank's estate (12 U.S.C. §§ 192, 1821). In its separate capacity as insurer of deposits, FDIC pays insurance and is subrogated to the payee's claim against the bank's estate in the amount of the insurance paid (12 U.S.C. § 1821). As it liquidates the bank, FDIC as receiver must make ratable distributions to all creditors, including itself as subrogee (12 U.S.C. §§ 194, 1821). These two separate capacities of FDIC are recognized in *Freeling v. Sebring,* 296 F.2d 244 (10th Cir. 1961). This brief is therefore filed by FDIC in its capacity as receiver of the Bank, in regard to the appellants' claims against the estate of the Bank. The brief is also filed by FDIC in its own capacity as insurer of deposits, in regard to the appellants' claims against FDIC's subrogation rights.

Appeal of Telephone Company
SUMMARY OF ARGUMENT

Telephone Company says that, because of fraud of the Bank, it is not in the position of a mere general creditor of the Bank's estate but is entitled to recover its whole deposit by way of rescission or constructive trust.

It then makes the alternative contention that since it received no excess interest it is an innocent depositor, and that the claims of depositors who took illegal interest should be subordinated to the claims of innocent depositors until the latter have been paid in full. In its complaint it also alleges that FDIC as subrogee of bounty depositors has no greater rights than such depositors.[23]

In response, appellee's contentions are these:

As to constructive trust:[24]

1. The facts alleged in the complaint do not constitute the hopeless and irretrievable insolvency which is necessary for a constructive trust.

2. The transaction on which Telephone Company relies was not a deposit but the renewal of a previous deposit. Therefore, the assets of the Bank were not augmented, and in consequence of that fact the Telephone Company was not entitled to a constructive trust in any event.

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[23]Tr., 9-10.

[24]The test being the same for rescission as for constructive trust, we refer to both claims as for constructive trust.

As to subordination of claims of guilty depositors:

1. The fact that depositors received bounty is not ground for the asserted subordination of their claims as general creditors, because a private action does not lie for breach of the Federal Reserve regulation as to interest, and, apart from that, such subordination would be inequitable.

2. Even if the claims of guilty depositors were to be subordinated, FDIC as subrogee claimant is not similarly subordinated.

ARGUMENT

I

TELEPHONE COMPANY IS NOT ENTITLED TO A CONSTRUCTIVE TRUST

A. The Bank Was Not Hopelessly and Irretrievably Insolvent

The facts alleged in the complaint do not constitute hopeless and irretrievable insolvency.

Such insolvency is necessary for a constructive trust:

Brennan v. Tillinghast, 201 Fed. 609, 615 (6th Cir. 1913);

Byrd v. Ross, 58 F.2d 377, 378, 379 (S.D.Fla. 1932);

Illinois Cent. R. Co. v. Rawlings, 66 F.2d 146, 150 (5th Cir. 1933), cert. denied, 291 U.S. 668 (1934).

The principle is stated in *Byrd v. Ross,* above (p. 378):

"A bank which is, to the knowledge of its managing officers, hopelessly and irretrievably insolvent, cannot honestly continue its business and continue to receive the moneys of its depositors. Although the bank's officers entertain no actual intent to defraud, nevertheless, when they know that the bank is hopelessly and irretrievably insolvent and receive money deposits on the eve of its failure, they commit a fraud on a depositor who, in ignorance of the condition of the bank, deposits his money therein."

It is also stated in *Illinois Cent. R. Co. v. Rawlings*, above (p. 150):

"It is well settled that the receipt of deposits when a bank, within the knowledge of its officers, is hopelessly and irretrievably insolvent, is a fraud on the depositor, who has a right to rely on the assurance of ability to pay the deposits on demand which the open bank creates. Such receipt operates to prevent the creation of the ordinary relation of banker and depositor, making the deposit trust funds. (Citations) Since, however, the trust is created only when there is fraud, the burden rests on the depositor to prove, not that the bank was insolvent when the deposits were made, but that it was hopelessly and irretrievably so within the knowledge of its officers.

* * * * * * *

"The rule has its sound supporting reasons. A bank is organized to receive deposits, and while it is a going concern it must continue to receive them. 'For it is obvious that to refuse to accept deposits would be equivalent to a cessation of business.' (Citation) A no less imperative duty rests upon the officers of a bank to keep it open

by receiving deposits, thus averting the losses that inevitably follow closing, than rests upon them to close the bank when it may no longer be kept open."

In a footnote, the court in the *Illinois Central* case quotes from *McDonald v. Chemical Nat. Bank,* 174 U.S. 610 (1898), as follows:

"It is matter of common knowledge that banks and other corporations continue, in many instances, to do their regular and ordinary business for long periods, though in a condition of actual insolvency, as disclosed by subsequent events. It cannot surely be said that all payments made in the due course of business in such cases are to be deemed to be made in contemplation of insolvency, or with a view to prefer one creditor to another. There is often the hope that, if only the credit of the bank can be kept up by continuing its ordinary business and by avoiding any act of insolvency, affairs may take a favorable turn, and thus suspension of payments and of business be avoided."

The complaint here fails to meet this test. It alleges that at the time of the renewal of the deposit "Bank was then either insolvent or in imminent danger of becoming insolvent . . .".[25] As we have seen, insolvency is not enough; it must be hopeless and irretrievable. And "imminent *danger* of *becoming* insolvent" is not even insolvency. The fact that the Bank continued to operate for nearly a month[26] after the renewal is

[25] Tr., 66.
[26] Tr., 6.

further indication of the fact that at the time of the renewal the condition of the Bank was not hopeless or irretrievable.

B. Renewal of a Deposit Is Not Ground for a Trust, Because It Does Not Augment Assets

Telephone Company claims a constructive trust because of the transaction of December 28, 1964.[27] That was not a deposit but a renewal of a deposit. Therefore, it did not augment the assets of the Bank; and for constructive trust the Bank's assets must be augmented by the action of the depositor at the time the trust is claimed to have been created.

> *Hennemann v. Rosebud Bank,* 78 S.W.2d 113 (Mo.App. 1935);
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> *Mallett v. Tunnicliffe,* 102 Fla. 809, 136 So. 346 (1931);
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> *Luikart v. Schmidt,* 138 Neb. 282, 292 N.W. 723 (1940);
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> *Fagan v. Whidden,* 57 F.2d 631 (5th Cir. 1932);
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> *Venner v. Cox,* 35 S.W. 769 (Tenn.Ch.App. 1895);
>
> *Barsness v. Tiegen,* 184 Minn. 188, 238 N.W. 161 (1931);
>
> *Allied Mills v. Horton,* 65 F.2d 708 (7th Cir. 1933);
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> Braver, *Liquidation of Financial Institutions,* pp. 39, 40 (1936).

References to a few of these cases illustrates the doctrine.

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[27] Tr., 7-8.

In the *Hennemann* case, a depositor sought payment of a certificate of deposit. The bank being unable to pay, he took a renewal certificate. When the bank failed, he claimed preference by a trust ex maleficio. Recovery was denied, the court saying (78 S.W.2d, p. 115):

> "The renewal was not in fact (whatever else it may have been in theory) the making of a new deposit. It was for the continuation of the former or original deposit under a new contract for an additional period of time. There was no actual money or other thing of value deposited in the bank by the plaintiff at such time or, upon plaintiff's theory, anything of value left therein by him. The plaintiff is not permitted to play fast and loose at pleasure. He did not, in fact, deposit anything in the bank upon that date; nor can he be permitted to say that he left a deposit in the bank from that date, which he had previously made therein, and at the same time say that the bank was insolvent and unable to pay such deposit. He cannot say that there was nothing in the bank to be left by him on that date, on which a claim for preference in his favor might arise, and at the same time assert a right to a preference as if it were there."

In the *Mallett* case, a depositor attempted to withdraw her savings deposit. She was dissuaded on the false representation that the bank was solvent. The bank closed 21 days later. The depositor sought to recover her deposit by impressing a trust. The court held that no trust was created. It said (136 So., p. 348):

> ". . . the depositor voluntarily and knowingly continued her relationship as a general depositor, or, in other words, as a general creditor of the bank. The fact that she did so through the fraud and deceit of an officer of the bank in inducing her not to change her relationship does not of itself convert the relationship from that of debtor and creditor to one of trustee and cestui que trust."

The court said that the case differed from the situation where a depositor was induced to *make a deposit* by false representations of solvency, in which situation the fraud prevented the title to the deposit from ever vesting in the insolvent bank.

In the *Luikart* case, the question was whether a renewal of a deposit absolved from liability persons who were shareholders at the time of the original deposit. The court said (292 N.W., p. 724):

> "To the depositor, certainly, it is pure fantasy to say that, when he renewed his certificate, the money was returned to him, and that he in turn passed it back over the counter to the bank. So far as he was concerned, there was but one controlling transaction, and that was when he parted with his money. The rest of it was incidental detail—collecting interest, and going to the bank to receive a substitute certificate or receipt, so that his interest payments would not be interrupted."

In the *Fagan* case, bank officials fraudulently concealed the existence of a deposit which would have been withdrawn if the owners had known of its existence. The court said (at p. 632):

> "That the officers of the bank have acted badly, and that for the damage caused by their fraudulent conduct they may be held personally to account, goes without saying. It is quite another thing, however, to say that the fraud of an officer of the bank, by which a depositor is prevented from carrying out a purpose to cease being a creditor of the bank converts him from a creditor of the bank into an owner of a specific amount of the bank's funds so that thereafter the bank is, as to that amount, not his debtor, but his trustee."

The case at bar is governed by those cases. What Telephone Company did on December 28 was not the making of a deposit but the renewal of a deposit. Hence it lacked the augmentation which is essential to creation of a constructive trust.

C. Appellant's Arguments Regarding Constructive Trust

As against these points, Telephone Company offers the following contentions.

Hopeless and Irretrievable Insolvency

It cites cases to the effect that receipt of a deposit by an insolvent bank is a fraud on the depositor entitling him to recover his deposit by way of constructive trust. As we have seen, however, to serve as a basis for a constructive trust the insolvency must have been hopeless and irretrievable. This appears not only in the cases cited by us but also in appellant's cases. For example, in *Carnegie-Illinois Steel Corporation v. Berger,* 105 F.2d 485 (3rd Cir. 1939), cert. denied, 308 U.S. 603 (1939), the court said (p. 487):

> "We think that the law may be stated as follows. If a bank accepts a deposit with knowledge upon the part of its officers and directors that it is hopelessly and irretrievably insolvent, there is a fraud perpetrated upon the depositor. The depositor may thereupon rescind the contract of deposit and recover the sum paid in or ask that a constructive trust be declared in his favor upon its proceeds."

Appellant cites *Tucker v. Newcomb,* 67 F.2d 177 (4th Cir. 1933), to the effect that constructive trust may be applied even where there is no insolvency if it was wrong for the bank to accept the deposit. The *Tucker* case is inapplicable factually, and its general principle is not the criterion here because here the basis of the claim is insolvency and there is specific law on the kind of insolvency which gives rise to the claim. Moreover, in the *Tucker* case there was an actual deposit at the time of the alleged wrong.

Lack of Augmentation

Telephone Company does not cite any case holding that renewal of a deposit augments the estate. In an endeavor to present analogies, it cites cases which are, however, wholly lacking in analogy. Thus, in *Federal Reserve Bank v. Idaho Grimm Alfalfa Seed G. Assn.,* 8 F.2d 922 (9th Cir. 1925), cert. denied, 270 U.S. 646 (1926), the question of augmentation was not involved, and the depositor was not seeking to enforce a trust or to follow trust funds but was suing in tort for which, as this Court said, a court of law affords a complete remedy.

In *American Nat. Bank v. Miller,* 229 U.S. 517 (1913), the payee of a check, instead of sending it through the clearing house sent it directly to the drawee bank where the payee maintained an account. The latter, shortly after receipt of the check, credited the payee's account and debited the maker's account. Thereafter, the drawee bank, learning that the maker had become insolvent, tried to cancel the credit so as to be able to offset the maker's account against a debt of the maker to the drawee bank. The basis of the drawee's claim that it should be able to rescind the credit entry to the payee's account was that the payee had fraudulently concealed the maker's insolvency. The court held against the drawee bank, however, because the payee had no knowledge of the insolvency. And the statement in the opinion that the crediting of payee's account was equivalent to payee receiving the money from drawee and then passing it back for deposit had nothing to do with trust or augmentation. It was merely a statement supporting the court's observation that when the drawee bank made the credit the process of collection was closed.

We will not consume the court's time with a particular discussion of the other cases, but a reading of them shows that they are inapplicable to the case at bar because they basically concern themselves with the check collection process and do not in any way involve certificates of deposit or renewals thereof.

Tracing of Assets

Appellant states that the December 28 deposit may be traced into the assets of the Bank since the Bank

committed a fraud upon appellant and thus had no right to commingle the deposit with other funds. But this assumes the augmentation resulting from a deposit whereas we contend that the December 28 renewal did not constitute a deposit.

II

TELEPHONE COMPANY IS NOT ENTITLED TO SUBORDINATION OF THE CLAIMS OF OTHER CREDITORS

As an alternate claim for reversal, Telephone Company says that since it received only the legal rate of interest, defendant depositors, who received an illegal rate or bounty, should be subordinated to it and to other innocent depositors. Though it does not treat the subject in its brief, it alleges in the complaint[28] that FDIC as subrogee of such depositors has no higher rights than they have.

A. Defendant Depositors Should Not Be Subordinated

Telephone Company's argument on this point is this. The Board of Governors of the Federal Reserve System are empowered by 12 U.S.C. § 371(b) to limit the rate of interest payable by national banks on time and savings deposits. Pursuant to that authority, the Board has specified that maximum amount of interest. It did so by what is called Regulation Q of the Federal Reserve System. The complaint alleges that the defendant depositors received consideration in excess of that rate. On that ground, Telephone Company seeks subordination of the claims of depositors receiving such illegal rate of interest

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[28] Tr., 9-10.

to the claims of Telephone Company. This amounts to saying that as a private litigant Telephone Company can bring a private action for violation of Regulation Q.

The answer to this contention is that the Federal Reserve regulations do not create a private cause of action. Rather, Congress intended that the regulatory controls under the Federal Reserve System be exercised solely by the Board of Governors or the Comptroller of the Currency. This was the holding of *Blaney v. Florida National Bank at Orlando,* 357 F. 2d 27 (5th Cir. 1966). Therefore, this claim of Telephone Company cannot be sustained.

Apart from that, Telephone Company's claim fails. It bases its contention regarding bounty depositors chiefly on the ground of equity. It says that it is unfair for depositors who violated the law by receiving illegal interest to share equally with depositors innocent of such a wrong.

It would be a harsh equity that would punish a depositor who received some extra interest by nullifying his entire claim to his deposit. That is what it would amount to; that is, if the claims of depositors who received any extra interest were to be subordinated until the claims of all other depositors were paid in full—which is what Telephone Company is contending—the former class of depositors would probably get nothing. This means that if a person with a million dollar deposit had received an extra half per cent of interest or an equivalent bounty, he would forfeit his whole million. That would not be equity; it would be a gross inequity.

Therefore, the only basis for such a result would have to be a statute. But there is no statute to that effect. The statute, on the contrary, says that claims are to be paid ratably. 12 U.S.C. § 194.[29]

B. FDIC Should Not Be Penalized

Even if a bounty depositor should be thus penalized, FDIC should not. FDIC is a creditor by virtue of having paid insurance on deposits. It is subrogated to the depositors' rights to that extent; but it is in that position by virtue of the duty imposed on it by law to pay insurance. In view of its mandatory duty and of its lack of connection with illegal interest, it would be inequitable to penalize it; and preservation of FDIC's right of subrogation also serves the public interest in that it protects the liquidity of FDIC's insurance fund.

For the reasons stated, the orders of the District Court should be affirmed as to Telephone Company's complaint against FDIC.

We will now discuss the appeals of Victoria and Security.

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[29]Section 194 provides:

"From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held."

Appeal of
Victoria Savings and Loan Association

In respect of the claim for constructive trust, Victoria presents substantially the same issues as Telephone Company. There were a couple of factual differences, but they did not affect the legal issues. The factual differences were that Victoria, which had five certificates of deposit for $100,000 each, did not renew the whole $500,000, but took a renewal certificate for $150,000, and took the balance of $350,000 plus $10,000 accrued interest in the form of a cashier's check; and the new certificate and cashier's check were dated January 16, 1965, and were received by Victoria on January 20.[30]

As against Victoria, therefore, this appellee reasserts the same contentions that it has made against Telephone Company regarding constructive trust, namely lack of the hopeless and irretrievable insolvency that is necessary for a constructive trust, and lack of augmentation of assets.

As we have seen, no augmentation results from the renewal of a certificate of deposit. The same is true of the issuance of the cashier's check. In both instances, the relationship between the Bank and the depositor remains the same, namely that of debtor and creditor. The effect of a cashier's check is described in *Clark v. Chicago etc. Co.*, 186 Ill. 440, 57 N.E. 1061 (1900), wherein the court said (57 N.E., p. 1062):

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[30]Tr., 16, 23-24.

> "The drawing of the cashier's check, even if it changed the form of indebtedness, did not change the fact. The Globe Savings Bank was still indebted to the appellant for the $3,000 represented by its cashier's check. There was no change in the nature of the debt. The only change was in the evidence of it."

In seeking subordination of claims, Victoria makes some charges against FDIC in its capacity as insurer rather than as receiver. It does so in the sixth count of its cross-claim.[31] In that count, Victoria, seeking to subordinate the claims of FDIC to those of innocent depositors, alleges substantially as follows:

It calls FDIC, the Comptroller of the Currency, and Federal Reserve Bank "responsible agencies," and it alleges:

> "The responsible agencies have different specific functions concerning the banking system, which are interrelated and are required to be exercised in conjunction with each other and with full coordination among the responsible agencies involved, all with a view to promoting a safe and sound banking system and providing assurance for depositors that they may deal with banks with full confidence that they are soundly and prudently operated."[32]

It also alleges:

> "During and throughout 1964 the responsible agencies, each having or being chargeable with knowledge that BANK was insolvent or in immi-

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[31]Tr., 29-33.
[32]Tr., 30.

> nent danger of insolvency, engaged in a course of conduct with BANK management and with each other, each taking actions in the exercise of their respective authority and coordinating their respective actions, in an effort to keep BANK open and to avoid disclosure of its true condition to the public, including existing and prospective depositors."[33]

It alleges that the course of conduct was undertaken to induce Victoria and others to make and maintain their deposits in the Bank, and that, relying thereon, Victoria acted to its detriment in making deposits; that the course of conduct was intended to inure to the benefit of FDIC to permit it to delay, reduce and conceivably avoid altogether any liability on its insurance obligations. It alleges that the responsible agencies "however much they may have acted in the belief that their actions were in the public interest" were aware of the potential damage to depositors; and it alleges further acts of the so-called responsible agencies which it claims misled the public as to the condition of the Bank.[34]

Appellee vigorously denies such allegations, and here treats them as true only for the sake or argument. So considered, no such action lies for them, for two reasons:

> 1. The claim comes under the Federal Tort Claims Act, and as such it is barred because FDIC is a federal agency and suits coming under

[33] Tr., 30-31.
[34] Tr., 31-33.

that Act must be brought against the United States rather than the agency; and even if it were brought against the United States, it would be barred by § 2680(h) of the Act because it is a claim for misrepresentation or deceit, and it would also be barred by § 2680(a) of the Act because it is a claim based upon the exercise of a discretionary function by a federal agency.

2. Even apart from the Tort Claims Act, such a suit is barred by the principle that the performance by executive officers of discretionary governmental duties entrusted to them by statute is not subject to judicial review.

We treat these points in the order mentioned.

I

VICTORIA'S CLAIM FOR SUBORDINATION OF FDIC IS BARRED BY THE FEDERAL TORT CLAIMS ACT

A. Suits Brought under the Tort Claims Act Must Be Brought against the United States, Not against the Federal Agency Involved

In 1946, Congress enacted the Federal Tort Claims Act, which act permits the government to be sued for certain torts. It is Chapter 171 of Title 28 of the U. S. Code.

The underlying section is § 2674, which provides:

> "The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances. . . ."

Prior to enactment of the Tort Claims Act, certain federal agencies could be sued in tort. This was by virtue of statutes which provided that those particular agencies could sue and be sued. One of the effects of the Tort Claims Act, however, was that after its enactment such suits could no longer be brought against the federal agencies themselves but had to be brought against the United States. In this respect, 28 U.S.C. § 2679(a) provides:

> "The authority of any federal agency to sue and be sued in its own name shall not be construed to authorize suits against such federal agency on claims which are cognizable under section 1346(b)[35] of this title, and the remedies pro-

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[35]Section 1346(b) provides:

"(b) . . . the district courts . . . shall have exclusive jurisdiction of civil actions on claims against the United States,

vided by this title in such cases shall be exclusive."

Federal Deposit Insurance Corporation is a federal agency, within the meaning of § 2671[36] of the Tort Claims Act and as such it is entitled to the protection of the Act. *Freeling v. Federal Deposit Insurance Corporation,* 221 F.Supp. 955 (W.D.Okla. 1962) aff'd per curiam, 326 F.2d 971 (10th Cir. 1963); *James v. Federal Deposit Insurance Corporation,* 231 F.Supp. 475 (W.D.La. 1964); *Edelman v. Federal Housing Administration,* 251 F.Supp. 715 (E.D.N.Y. 1966). Therefore, since the suit is not against the United States, the suit fails.

B. Even If Brought against the United States, the Suit Would Fail because It Would Be Barred by Sections 2680(h) and 2680(a) of the Act

Moreover, even if the suit had been filed against the United States, the Federal Tort Claims Act, although recognizing governmental tort liability, excludes certain torts from those for which the government may be sued. Among those excluded are

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for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred."

[36]Section 2671 provides:

"As used in this chapter and sections 1346(b) and 2401(b) of this title, the term 'Federal agency' includes the executive departments, the military departments, independent establishments of the United States, and corporations primarily acting as instrumentalities or agencies of the United States, but does not include any contractor with the United States."

misrepresentation and deceit. This appears in § 2680, which reads:

> "The provisions of this chapter and section 1346(b) of this title shall not apply to—
>
> * * * * * * *
>
> (h) Any claim arising out of . . . misrepresentation, deceit . . ."

In other words, while the government permits itself to be sued for certain torts—notably for injuries to person and property—it expressly declines to expose itself to liability for misrepresentation or deceit. Victoria's claim against FDIC is based upon charges of misrepresentation or deceit. Therefore, it is expressly barred by the statute.

It is also barred by Section 2680(a) which provides:

> "The provisions of this chapter and section 1346(b) of this title shall not apply to—
>
> "(a) Any claim . . . based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused."

As we have seen, Victoria expressly alleges that FDIC's alleged acts were done in the exercise of its authority; and they were manifestly discretionary acts. The Supreme Court in *Dalehite v. United States,* 346 U.S. 15 (1953), said that where there is room for policy judgment and decision there is discretion. In that respect, the court said (p. 35):

> "It is unnecessary to define, apart from this case, precisely where discretion ends. It is enough to hold, as we do, that the 'discretionary function or duty' that cannot form a basis for suit under the Tort Claims Act includes more than the initiation of programs and activities. It also includes determinations made by executives or administrators in establishing plans, specifications or schedules of operations. Where there is room for policy judgment and decision there is discretion. It necessarily follows that acts of subordinates in carrying out the operations of government in accordance with official directions cannot be actionable."

Therefore Victoria's claim for this relief is barred by § 2680(a).

The authorities support this conclusion. In *Schmidt v. United States,* 198 F.2d 32 (7th Cir. 1952), a shareholder of Tucker Corporation brought suit complaining of the conduct of the Securities and Exchange Commission (SEC). It was alleged that Tucker's automobile business was destroyed by a conspiracy of SEC and others, that SEC gave adverse publicity to Tucker, threatened publicly to investigate the concern and in fact did so investigate; that the conduct of the SEC allegedly violated the antitrust laws and also constituted a common law tort of willful business injury. The court held that all of SEC's actions were discretionary in character and that in consequence the suit was barred by the Federal Tort Claims Act. To the same effect with respect to discretionary acts of the SEC is *Holmes v. Eddy,* 341 F.2d 477 (4th Cir. 1965).

The fact that the acts complained of by Victoria were those of a combination of three "responsible agencies" does not take the matter out of the exception for discretionary acts. *Radford v. United States,* 264 F.2d 709 (5th Cir. 1959).

Nature of the Claim

On its motion to dismiss which led to the May 25 order of the District Court, appellee raised the point of the bar of the Tort Claims Act.[37] In reply, Victoria contended that the Tort Claims Act was inapplicable because this was not a claim for "money damages."[38] The phrase "money damages" appears in § 1346(b),[39] which we have quoted above. For the Court's convenience, we repeat it here:

> "(b) . . . the district courts . . . shall have exclusive jurisdiction of civil actions on claims against the United States, for *money damages,* accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United

[37]Tr., 126-127.

[38]Tr., 138.

[39]Section 1346(b) is pertinent to the Tort Claims Act because of reference to it in two sections of the Act, namely in the above quoted § 2679(a), which provides that "The authority of any federal agency to sue and be sued in its own name shall not be construed to authorize suits against such federal agency on claims which are cognizable under section 1346(b) of this title, and the remedies provided by this title in such cases shall be exclusive", and in the above quoted § 2680, which provides that "the provisions of this chapter and § 1346(b) of this title shall not apply to [certain enumerated kinds of torts]."

> States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred." (Emphasis supplied.)

Victoria's argument is that a claim for subordination of creditors is not a claim for "money damages" and is therefore not barred by the Tort Claims Act.

Our responses to this are:

1. A claim which seeks to subordinate the claims of one creditor to those of another is in effect a claim for "money damages;" and
2. The Federal Tort Claims Act by § 2680(a) and (h) precludes not merely claims for money damages but *any claims.*

1. A Claim for Subordination Is a Claim for Money Damages

In the present case, Victoria seeks to subordinate the claims of FDIC to its own claim. Such a form of relief is in effect the same as a claim for compensatory damages. It increases the money which Victoria will get from the Bank's estate, and reduces the money which FDIC will recover. It is out-of-pocket loss to one party and in-pocket gain to the other. In other words, though as far as the form of its claim goes, Victoria is seeking subordination of claims of a creditor, in fact it is trying to get money for alleged torts. In view of this identity in effect between a simple money judgment and the monetary result of subordination, we submit that subordination should be treated as a claim for "money damages" within the prohibitive sections of the Federal Tort Claims Act.

2. The Federal Tort Claims Act Precludes Any Claim Arising out of Misrepresentation Or Out of Discretionary Acts, Not Merely Claims for Money Damages

The section of the Tort Claims Act which prohibits certain actions is Section 2680.[40] The prohibitions in it against claims based on discretionary functions and

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[40]Section 2680 is as follows:

"The provisions of this chapter and section 1346(b) of this title shall not apply to—

(a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

(b) Any claim arising out of the loss, miscarriage, or negligent transmission of letters or postal matter.

(c) Any claim arising in respect of the assessment or collection of any tax or customs duty, or the detention of any goods or merchandise by any officer of customs or excise or any other law-enforcement officer.

(d) Any claim for which a remedy is provided by sections 741-752, 781-790 of Title 46, relating to claims or suits in admiralty against the United States.

(e) Any claim arising out of an act or omission of any employee of the Government in administering the provisions of sections 1-31 of Title 50, Appendix.

(f) Any claim for damages caused by the imposition or establishment of a quarantine by the United States.

(g) Repealed.

(h) Any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights.

(i) Any claim for damages caused by the fiscal operations of the Treasury or by the regulation of the monetary system.

(j) Any claim arising out of the combatant activities of the military or naval forces, or the Coast Guard, during time of war.

(k) Any claim arising in a foreign country.

(l) Any claim arising from the activities of the Tennessee Valley Authority.

(m) Any claim arising from the activities of the Panama Canal Company.

(n) Any claim arising from the activities of a Federal land bank, a Federal intermediate credit bank, or a bank for cooperatives."

those arising out of misrepresentation or deceit are not limited to claims for money damages. They expressly include "any claim." Thus the section provides:

> "The provisions of this chapter and section 1346(b) of this title shall not apply to—
>
> "(a) *Any claim* . . . based upon the exercise . . . or the failure to exercise . . . a discretionary function . . .
>
> * * * * * * *
>
> "(h) *Any claim* arising out of . . . misrepresentation, deceit . . ." (Emphasis supplied.)

Furthermore, in all the subdivisions of § 2680 except (f) and (i) the prohibition is against "Any claim," whereas under subdivisions (f) and (i) "Any claim *for damages*" is prohibited. (Emphasis supplied.)

If Congress had intended that the Tort Claims Act should be limited in all respects to claims for money damages, there would have been no reason for including the phrase "for damages" in respect of the causes of action described in subdivisions (f) and (i); and to interpret the statute otherwise would be to disregard this statutory differentiation. This would violate the rule that words of a statute should never be considered surplusage if a reasonable construction can be adopted which will give force to and preserve all the terms of the statute.

Application of Rogers, 229 F.2d 754 (9th Cir. 1956);

England v. Moore Equipment Co., 94 F.Supp. 532 (N.D.Cal. 1950).

II

APART FROM THE TORT CLAIMS ACT, FDIC IS NOT LIABLE FOR THE DISCRETIONARY ACTIONS OF ITS OFFICERS PERFORMED WITHIN THE SCOPE OF THEIR GOVERNMENTAL AUTHORITY

Even if it were to be held that the Federal Tort Claims Act is inapplicable because a claim for subordination is not a claim for "money damages," appellant is still precluded from maintaining the present action for subordination against FDIC because of the principle that the performance by executive officers of discretionary governmental duties entrusted to them by statute is not subject to judicial review. *Pacific Nat. Fire Ins. Co. v. Tennessee Valley Authority,* 89 F.Supp. 978 (W.D.Va. 1950); *Atchley v. Tennessee Valley Authority,* 69 F.Supp. 952 (N.D.Ala. 1947); *Grant v. Tennessee Valley Authority,* 49 F. Supp. 564 (E.D.Tenn. 1942); *Adams v. Home Owners Loan Corporation,* 107 F.2d 139 (8th Cir. 1939).

In *Atchley v. Tennessee Valley Authority,* supra, plaintiff alleged that while defendant corporation was exercising powers committed to it by Congress by operating a system of dams and reservoirs to control flood waters, defendant negligently raised the waters in a certain reservoir until they overflowed and ruined plaintiff's crops. In a second count, plaintiff alleged that the action was done wilfully. The court held that the claim did not state a cause of action against the corporation, even though it consented to suit, stating (p. 955):

> "The present case comes clearly within the principle that the performance by executive officers

of discretionary governmental duties entrusted to them by statute is not subject to judicial review. This principle has been reiterated time and again in mandamus proceedings to compel executive action, in injunction suits to prevent executive action, and in actions such as that at bar for damages claimed to have resulted from executive action."

In *Pacific Nat. Fire Ins. Co. v. Tennessee Valley Authority,* supra, suit was brought against the Authority for damage to property resulting from a blast of explosives set off by defendant. The court held that the action did not lie. It said (p. 979):

> "Although plaintiff alleges negligence in general terms, the sum and substance of its complaint is that defendant set off so large an explosion that it knew, or should have known, that damage to the Miller residence might result therefrom. Defendant is a Government agency, but it is provided by law that the corporation 'may sue and be sued in its corporate name'. Section 4(b) of the Tennessee Valley Authority Act, 16 U.S.C.A. § 831c(b). Defendant, by counsel, admits that, in certain instances, it would be liable for negligent acts of its agents. It contends, however, that in this instance the act complained of was done in the performance of a discretionary governmental duty entrusted to it by statute. There can be no question that the construction of the South Holston Dam was authorized by statute, and that the method of its erection was entrusted to the defendant. I agree with defendant that the setting off of the explosion described herein was in the performance of a discretionary gov-

ernmental duty. Therefore, even if defendant was guilty of an abuse of discretion, it would not be liable for damages resulting therefrom. The principle seems well settled that the performance by executive officers of discretionary governmental duties entrusted to them by statute, is not subject to judicial review. (Citations)"

12 U.S.C. § 1819 provides that FDIC may "sue and be sued . . . in any court of law . . . state or federal," but it is held that such a statute does not nullify the principle above mentioned, that a governmental agency is not subject to suit for its discretionary acts. This appears in the *Pacific Nat. Fire Ins. Co.* case, as above shown, and also in the *Atchley* case, wherein the court said (pp. 953-954):

"The plaintiffs here rely, just as did the plaintiffs in the Grant case, on the provision in section 4(b) of the Tennessee Valley Authority Act, 16 U.S.C.A. § 831c(b), that the corporation 'may sue and be sued in its corporate name.' In support of their position, plaintiffs cite the following cases: (citations) In my opinion, these cases do not sustain the plaintiffs' position. A distinction must be recognized between the procedural question of whether a government corporation is subject to suit and the substantive question of whether a given set of facts establishes its liability as a matter of substantive law. The sue-and-be-sued clause in the TVA Act does nothing but remove the procedural bar to suit against an agency of the federal government. It does not engender liability in a case where liability would not otherwise exist."

The principle was also recognized by the court in *Grant v. Tennessee Valley Authority,* wherein the court said (p. 565):

> "From this quotation and a review of the whole opinion, I am impressed with the idea that the inclusion of 'the conventional to-sue-and-to-be-sued clause' in the Tennessee Valley Authority Act is not a shibboleth to engender liability generally, but is to be taken into consideration with the congressional purposes in creating this governmental corporation."

The acts which Victoria alleges were committed by FDIC come clearly within the doctrine of the above cases. Such acts if committed would have been a part of the governmental functions imposed upon FDIC by statute and they would have been manifestly discretionary in character. *Dalehite v. United States,* above. For these reasons, independently of the Tort Claims Act, the action is barred.

VICTORIA'S REFERENCE TO PROCEEDING NO. 43512

A receiver of a national bank is required by 12 U.S.C. §192 [41] to get court approval of sales or compromises arising out of the liquidation of the bank.

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[41]The pertinent portion of the section is this:

"... Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, *upon the order of a court of record* of competent jurisdiction, may *sell or compound* all bad or doubtful debts, and, on a like order, may *sell all the real and personal property* of such association, on such terms as the court shall direct. ..." (Emphasis supplied.)

FDIC, in connection with its liquidation of Bank, has, from time to time, petitioned the district court for such approvals. These petitions[42] were each entitled "In the Matter of the Liquidation of San Francisco National Bank" and each was given the same civil action number—43512—by the clerk of the district court. The petitions filed by FDIC did not and could not give to the district court a general power of supervision over the liquidation of the Bank, nor did they or could they provide a forum for the adjudication of claims against the Bank's estate. They were merely the vehicle which FDIC utilized to secure the court approval required by 12 U.S.C. § 192 for sales and compromises. In between court approval of one petition and the filing of the next, there was nothing pending before the U. S. District Court. The conclusion here expressed is supported by the decisions of this Court in *Fifer v. Williams,* 5 F.2d 286 (9th Cir. 1925) and in *Gockstetter v. Williams,* 9 F.2d 354 (9th Cir. 1925).

Judge Mathes in his orders of May 25 stated that his ruling was without prejudice to the right of plaintiff and cross-claimants to seek intervention in proceeding No. 43512. Thereafter, Victoria and the other appellants herein filed petitions to intervene in that Matter, which petitions were denied by Judge Wollenberg.[43]

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[42]Tr., 1-5; 167-173; 301-339 in No. 21258 now pending in this Court.

[43]Tr., 151-152 in No. 21258 now pending in this Court.

As a result of Judge Mathes' and Judge Wollenberg's orders, Victoria in its opening brief herein contends that "it is inequitable for FDIC to argue in both this case and in the liquidation proceeding that the claims of these appellants should be dismissed, and in effect, that they, therefore, have no legal remedy in federal courts."

This appears to say that FDIC is arguing that Victoria has no right to a hearing either in this case or in No. 43512. FDIC makes no such argument. On the contrary, FDIC says that the proceedings for the adjudication of Victoria's rights is a plenary suit, which the present suit is, and FDIC's contention is that in this suit Victoria has failed to state a claim upon which relief can be granted.[44]

[44]Victoria and the other appellants herein have appealed from the order of Judge Wollenberg denying their petitions to intervene in proceeding No. 43512. Those appeals are now pending before this Honorable Court, where they are numbered 21258 A-C. In their opening briefs in those appeals, appellants contend that if the present plenary suit is not the proper forum for the adjudication of their claims, they are entitled to get such adjudication in proceeding No. 43512. In our brief in No. 21258 we will respond to the latter point, and we will there present the reasons why No. 43512 is in no sense a forum for the adjudication of such claims, but that such claims must be adjudicated in a plenary suit.

Appeal of Security Savings and Loan Association

Security has adopted the brief of Telephone Company. The facts in relation to Security are the same as those of Telephone Company, except that it renewed six $100,000 certificates of deposit totalling $600,000 and it did so on October 20, 1964. Its pleading[45] with regard to insolvency and subordination and the relief sought is substantally the same as Telephone Company's.

We therefore rely upon the contentions above asserted with respect to this appellant.

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[45]Tr., 191-208.

CONCLUSION

Telephone Company is not entitled to a constructive trust, because the Bank was not hopelessly and irretrievably insolvent, and even if it were, the renewal of a deposit is not ground for such a trust because it does not augment the assets of the Bank.

Telephone Company is not entitled to subordination of claims of other creditors, because (a) such a claim would amount to a private action to enforce a government regulation, which is not permitted; (b) even if such an action were not thus prohibited, such subordination would be inequitable; and (c) in any event, FDIC should not be thus penalized, because it became a creditor by virtue of having paid insurance under a mandatory provision of the law.

Victoria's claim for constructive trust is barred for the same reason as that of Telephone Company.

Victoria's claim for subordination is barred (a) by the Tort Claims Act, in that suits coming under that Act must be brought against the United States rather than a federal agency; and even if it were brought against the United States, it would be barred by section 2680(h) of the Act because it is a claim for misrepresentation or deceit and it would also be barred by 2680(a) of the Act because it is a claim based upon the exercise of a discretionary function by a federal agency, and (b) even apart from the Tort Claims Act the suit is barred by the principle that performance by executive officers of discretionary governmental duties entrusted to them by statute is not subject to judicial review.

The claim of Security is barred for the same reasons as that of Telephone Company.

It is respectfully submitted, therefore, that the orders of the trial court should be affirmed.

Dated, San Francisco, California,
May 17, 1967.

Respectfully submitted,
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Certificate of Counsel

I certify that, in connection with the preparatio of this brief, I have examined Rules 18, 19 and 39 the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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